Social Transformations in Contemporary Society 2021
ISSN 2424-5631 (online)

THE LEGAL NATURE OF CORPORATE GROUPS ENTITIES: IDEAS ON THE FUTURE OF ARM'S LENGTH PRINCIPLE AND TRANSFER PRICING IN INTERNATIONAL BUSINESS TAXATION

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Abstract

The search for an effective taxation of business income derived from the activities of multinational corporate groups is one of the main challenges of the current international tax system, which is built around the idea that related parties should carry economic relations as if they were independent, observing market conditions and the arm's length principle. This background is based on the 'entity approach', in corporate law terms, but does not seem to fit the hardly argued consensus that the global and digital economy is characterized by highly integrated and widespread groups, acting as one, thus fitting the notion of the 'enterprise approach'. This dichotomy found even more practical repercussions, in the field of international taxation, since the development of the work carried out by the OECD in 'taxing the digital economy' and the consequent discussions on new allocation nexus, differently than transfer pricing and arm's length principle, and moving towards a practical application of the 'enterprise approach'. The paper presents an overview on both the theoretical and practical implications of an adoption of each of the approaches, discusses the problems found at current OECD proposals and presents the outlines for an alternative solution to this dichotomy in the field of international taxation.

Purpose – The paper aims to identify both the theoretical background and the practical implications of the legal definition of entities inside corporate groups to the ongoing discussions on the redefinition of business income tax rules applicable to intra-group cross border activities. By doing so, the paper has the purpose to introduce the importance of such a discussion as a backbone for any new nexus to be advocated by the OECD and other international players in terms of designing a modified international tax system.

ISSN 2424-5631 (online)

Design/methodology/approach – The research is based on a multidisciplinary and comparative methodology. Firstly, the paper should discuss concepts under the umbrella of corporate law and some of its founding principles, in order to apply these concepts to the scenario of international taxation, not only in terms of legal implications, but also minding issues related to tax policy. On the other hand, the comparative methodology is adopted when confronting current international standards to the recent OECD proposals to redefine the international tax system.

Finding – The paper represents the current state of development of a work in progress, which should culminate in a chapter of the author's doctoral thesis. Therefore, the findings presented at this paper should not be read as final. Nevertheless, based on the current progress of the research, the paper presents the outermost practical importance in the definition of a legal nature for corporate groups when designing new allocation nexus for business income derived from the international activities of such groups. The research was also able to find that the current OECD proposals, by unclearly mixing both the entity approach and the enterprise approach, should be more carefully and clearly developed. Some important aspects, as the outline of a solution, are also presented as findings of the paper.

Research limitations/implications – It is recognized that the definition of the legal nature of corporate groups have significant impact in several legal fields, as, for example, in terms of insolvency law. It is not under the scope of this paper to discuss the implications of the definition of the legal nature of corporate groups outside the boundaries of international taxation. The issues discussed in relation to liabilities, for example, will not be analyzed under the lights of other kinds of liabilities rather than the fiscal ones.

Practical implications – The paper is aimed to have a practical implication on the current discussions, led by the OECD, in terms of the redefinition of the allocation nexus for cross border business income taxation, especially under its recently published 'unified approach'.

Originality/Value – The determination of the legal nature of corporate groups, although recognized in the paper as the backbone for the ongoing discussions on the relocation of taxing rights among jurisdictions where multinational corporate groups operate, has not yet been sufficiently tackled by academics in the field of international taxation. Most of the research published focus on the frames of corporate law and does not specifically address international taxation issues. This paper brings the outlines of an original solution to international taxation challenges, based on a proper analysis of the legal nature of corporate groups.

Keywords: Corporate Groups; International Taxation; Arm's Length Principle; Entity Approach; Enterprise Approach.

Research type: viewpoint.